REGIONAL INDUSTRIAL POLICY

HUGH BEGG

STUART McDOWALL

In this article we are principally concerned with the recent changes in regional industrial policy and their particular application in, and consequences for, Scotland.

The Assisted Areas in Great Britain are experiencing high and rising levels of unemployment coupled with an evident process of de-industrialisation. There is now something of a consensus that this situation can be expected to continue for the foreseeable future. Even taking "low" estimates of labour supply and matching these with "optimistic" forecasts of labour demand there is likely to be a substantial excess of supply over demand in the Assisted Areas over the next decade.

The traditional objectives of regional policy have been twofold:

(a) bringing supply and demand for labour in the Assisted Areas more closely into balance;
(b) helping regions to move towards self-sustaining growth.

It is, therefore, at first sight surprising that in its most recent policy changes Government has once again reduced the resources available for the achievement of these objectives. Indeed the current arrangements cut regional aid to an estimated total of £400 million in 1977/78 instead of the £700 million projected under previous policies and £1 billion if policies had remained unchanged since 1978.

Regional Policy: The Historical Context

In Great Britain successive governments have been committed to maintaining an effective regional policy to ease the process of change in areas which have been dependent on declining industries and to encourage new businesses in these areas. Over the years there have been major expenditures on a variety of regional policy packages which have varied in their composition and in the intensity of their application. The antecedents of the present policy instruments can be traced back to the policy packages devised in the 1960s. Indeed, the period 1966-1970 can now be recognised as a high point in the policy of systematic discrimination in favour of the less prosperous regions of the United Kingdom. The 1970s saw an erosion in the scope and intensity of such policy application as successive governments monitored policies and responded to new sets of problems.

Throughout the past twenty years or so, and certainly since the removal of the Regional Employment Premium in 1976, the main instruments of policy have been incentives to investment for manufacturing industry. The vast majority of expenditure has been non-discretionary (automatic) and not specifically related to the employment involved. Thus, political imperatives have required successive administrations to emphasise job creation as the principal objective of regional policy with the implication that expenditure will reduce levels of unemployment. However, closer inspection suggests that in fact the underlying thrust of the policy in recent years has been towards the restructuring of the manufacturing sector within the Assisted Areas in the face of rapid job loss within the industrial base.

The amounts expended on regional industrial incentives are readily identifiable elements of public expenditure and as such have been the subject of critical examination by successive governments:

> "Much has been spent and much may well have been wasted. Regional policy has been empiricism run mad, a game of hit-and-miss played with more enthusiasm than success."(1)

In the past fifteen years or so, however, there has been a substantial research effort which has increased our understanding of the workings of regional policy and the nature and extent of its influence on the economy. There is now a broad consensus that this regional industrial policy has been successful in a number of areas towards which it has been explicitly directed. Thus, it can be shown that, given past trends, actual investment and job creation in the Assisted Areas have been rather greater than might have been expected in periods during which an active regional policy has been pursued than in periods when there has been a lesser commitment.

Background to Current Policy

One of the first acts of the Conservative Government when it came to power in July 1979 was to conduct a review of regional industrial policy. The review was variously criticised on the grounds that it was superficial in

its approach, clumsy in its application and based on a false diagnosis of the problems and potentials of the Assisted Areas.

Thus for instance:

> "Enough has changed in the nature and context of regional and urban problems that a thorough reappraisal is the only logical basis for the future development of policy to deal with them. The problems are too large, complex and persistent to be tackled ad hoc, either by disjointed revisions and additions to existing policy or by sporadic new initiatives aimed at localised symptoms."(2)

Recognition of the nature and gravity of regional problems in the United Kingdom was followed by a number of studies which sought, inter alia, to restate policy objectives and come forward with a set of workable prescriptions compatible with other elements of government policy. Of these, three are of particular interest.

Perhaps the most significant academic contribution was the special edition of the Cambridge Economic Review devoted to a consideration of how Government might best tackle urban and regional problems in the context of the prolonged economic recession.(3) Many of the notions contained in the Review were given an explicit political thrust by the Labour Party in its Alternative Regional Strategy produced to complement its Alternative Economic Strategy.(4)

A third response was the Inquiry into Regional Problems in the United Kingdom conducted by the Regional Studies Association. Its panel drew upon evidence from a range of academics and practitioners from a variety of disciplines and of differing political views. The conclusions and recommendations of the Inquiry Panel were highly critical of the Government approach to regional problems.(5)

Although each of these studies differed in the details of its analysis and policy prescription a number of common themes can be identified: first, regional problems exist, and substantially greater resources should be made available for their solution; second, substantial administrative changes may be necessary for the effective implementation of policy; and, third, regional policy should be specifically designed to reinforce other main policies of government.

These themes were in direct contrast to the position held by Government. Its approach to regional industrial development was firmly set within its general economic philosophy. In particular a strong inclination for market solutions for economic problems and, related to this, further reductions in Government expenditure.

Given the relatively high levels of unemployment prevalent throughout the country, Government had concluded that the principal arguments for continuing with regional policy were social rather than economic. Nevertheless, Government decided that regional industrial incentives still had a role to play in encouraging new, existing and immigrant firms in the Assisted Areas.

There are at least three reasons why Government retained its commitment to regional policy. First, there was the longstanding and politically important commitment to supporting economic development in the less favoured regions of the United Kingdom. Secondly, an active regional policy was necessary to match incentives available from other countries to the limited supply of internationally mobile investment. Thirdly, the process of de-industrialisation was proceeding at such a pace in many of the regions of the country that regional policies were required, if not to achieve a virtuous cycle leading to self-sustaining growth, then to prevent a potentially disastrous downward spiral of self-perpetuating decline.

The White Paper: Cmnd 9111

In December 1983 Government published its policies in a White Paper on regional policy: Regional Industrial Policy (Cmnd 9111). The White Paper dealt with two main issues: it set out the general approach of Government to regional industrial policy, and it proposed a number of changes in the package of regional incentives. In the former case it affirmed that:

> "The Government are committed to an effective regional industrial policy designed to reduce, on a stable long-term basis, regional imbalances in employment opportunities."(6)

In the latter it announced that:

> "Legislation is being introduced to change the present scheme of regional development grants to make them more cost- effective. The Government expect that the combined effect of this change and those to the geographical coverage of the scheme would offer opportunities for reduction in public expenditure."(7)

The White Paper was rather unusual in two respects: first, the Department of Industry published an associated background paper in which it assessed studies of the effectiveness of regional industrial policy and discussed other issues raised during the Government's review. Second, and related to this, it invited views on a number of issues of policy which were not as yet decided. This, then, was a "White Paper with green edges": an interim and partial statement of policy which was the subject of widespread criticism notably on the grounds that it demonstrated the fragility of the Government's commitment towards regional policy.

As we have seen, the context within which regional policy can be pursued in the 1980s has changed markedly from that which pertained in the 1960s. In particular there are likely to be relatively high levels of unemployment throughout the United Kingdom and not only in the traditionally Assisted Areas. Within this context, in the White Paper, Government took the view that:

> "... imbalances between areas in employment opportunities should in principle be corrected by the natural adjustment of labour markets."(8)

However, given the complexities of industrial and commercial experience, it, perhaps reluctantly, reached the conclusion that:

> "Wage adjustment and labour mobility cannot be relied upon to correct regional imbalances in employment opportunities."(9)

Government is convinced that its principal objective must be to generate policies for a national economy characterised by an adequate rate of growth. In so far as regional incentives to industry operate simply as a re-distributive mechanism transferring activity from preferred to less-preferred locations then their application is counter-productive. This, for instance:

> "... regional incentives may have encouraged investment in locations that are not the best for the companies: the national economy may have suffered in consequence."(10)

It is considerations of this kind which have led Government to the view that the economic case for regional policy is now weak:

> "Although an economic case for regional industrial policy may still be made, it is not self-evident. The Government believe that the case

for continuing the policy is now principally a social one with the regional imbalances in employment opportunities."(11)

A review of regional industrial assistance in Great Britain shows that total expenditure in 1982/83 amounted to some £917 million. Of this, £137 million was given over to land and factories, £90 million to regional selective assistance, and about £690 million was expended on regional development grants.

The latter two incentives have rather different characteristics: selective financial assistance was discretionary and project-related, the amount awarded being the minimum necessary for the project to go ahead; regional development grant was paid "automatically" for the provision of new physical assets for use on qualifying premises. In its search for means of cutting public expenditure and also rendering the regional incentives more cost-effective, the Government gave particular attention to the role of regional development grants. In particular it took up three points:

1. that some projects received very large amount of grant although they might well have gone ahead anyway in the same location without assistance;

2. the grants were not linked in any way to the creation of jobs;

3. the policy was unlikely to realise its potential if it continued to concentrate on the rapidly contracting manufacturing sector.

With these points in mind the Government proposed a number of reforms in the structure of regional incentives:

1. discretional assistance would account for a larger *proportion* of expenditure

2. assistance would be targeted more closely on job creation;

3. assistance would be extended to include some service activities.

On regional selective assistance the view was:

> "... the Government believe that it is an effective and economical incentive. They intend to increase its share of expenditure relative to that on regional development grants."(12)

On regional development grant, on the other hand, the view was:

> "Industry attaches considerable importance to our grant scheme which incorporates standard rates of grant, is predictable in its application and which, by virtue of its predictability, can be taken into account at all stages of making investment decisions. Consequently, although it is proposed that the regional development grant scheme should be substantially revised in order to increase its cost-effectiveness, a high degree of predictability will be retained and the scheme will continue as the major element in regional industrial incentives."(13)

The New Arrangements

On 28 November 1984, four orders were placed before Parliament which brought into force the latest changes in the regional policy package. In summary, Government anticipate that the effect of the new arrangements will be to reduce UK expenditure on regional development grants and regional special assistance by some £300 million to £390 million. These estimates are not limits, and the actual expenditure will depend on a number of variables, notably the amount of investment activity in the economy and, linked to this, the rate of take-up of regional incentives.

The estimated cuts in future expenditure will be achieved as a result of two sets of changes. The first is in the areas within which incentives will be made available; the second is in the regional development grant scheme itself.

A new regional policy map has been drawn based on the revised Travel to Work Areas (TTWAs) devised by the Department of Employment on the basis of 1981 Census data. The old map of Assisted Areas was made up of Special Development Areas, Development Areas, and Intermediate Areas. The new map establishes a two-tier structure of Development Areas and Intermediate Areas. In the Development Areas firms will be eligible for regional special assistance and regional development grant. In the Intermediate Areas firms will be eligible only for regional special assistance. The effect of these changes has been to extend to 35% of the working population coverage of RSA and also the areas in which assistance from the Eruopean Regional Development Fund can be claimed. However, it has reduced the coverage of firms eligible for both RDG and RSA to 15% of the working population. While anomalies in the resultant map provide the evidence that other factors have been taken into account it is clear that the principal criterion for judging the status of an Assisted Area remains its rate of unemployment compared with other TTWAs.

The White Paper clearly stated the Government's intention to increase the relative importance of selective financial assistance compared with the regional development grant. Within the context of a substantially reduced total expenditure on regional industrial incentives this has been achieved by extending the coverage to which RSA can be applied while at the same time introducing a new regional development grant scheme. The esssentials of the new scheme are that it will be project- rather than item-related and that RDG be paid only on 15% of investment in qualifying activities subject to a limit of £10,000 per job created. However, as an alternative, RDG of £3,000 per job created will be paid. The amount to be given will be calculated on whichever of job grant or capital grant is more favourable to the firm.

As foreshadowed in the White Paper, the range of qualifying activities for RDG has been extended to include certain service activities. However, as a result of a commitment made to the European Commission in 1981, grants will not be available for replacement investment or for modernisation which involves no increase in jobs. Important exceptions to the grant per job limit are small firms, in this case defined as having less than 200 employees and bringing forward projects with less than £500,000 of investment.

The Impact of the Policy Changes on Scotland

The new changes in policy have particular consequences for Scotland. It is anticipated that by 1987/88 total expenditure on selective assistance and the new regional development grant scheme will have fallen by some £90 million to £104 million. The former Assisted Area map covered some 71% of the working population and this has fallen to 65% under the new arrangements. The area covered by RDG has fallen to 50% of the working population. The effect has been to concentrate aid on fewer areas identified by their relatively high unemployment, as being in particular need of job creation. The administration of the new and rather more complex regional development grant scheme has been transferred to the Industry Department Scotland and thus added to its existing responsibilities for the administration of RSA. No changes have been made in the powers or spheres of influence of the Scottish Development Agency or the Highlands and Islands Development Board. In addition the whole of the area covered by the HIDB as well as the Intermediate Areas will, according to Government, continue to be eligible for aid from the European Regional Development Fund.

The announcement of the policy changes was not well received in Scotland. As might be expected the major criticism was focussed on the size of the forecast reductions in expenditure. These were estimated at some 46% by 1987/88 by the Government. However, Ashcroft, on plausible assumptions, has forecast the reduction may be as much as £111 million or 68%.[14]

The Scottish Development Agency, the Scottish Confederation of British Industry, the Scottish Trades Union Congress, and the Scottish Council (Development and Industry) in a rare show of unanimity, all deplored the cuts.

An editorial in *The Scotsman* put the position as follows:

> "The only certain comment that can be made about the changes in regional policy is that they will achieve the Government's main objective – saving money. This will be a matter for some congratulation inside the Cabinet but whether it will do anything to help reduce the regional imbalances within the national economy is quite a different matter ..."[15]

There was also criticism of the new regional policy map. Predictably this centred on the criteria for delimiting the new TTWAs and for establishing their status. Thus, for instance, the linking of the Blairgowrie LEO with the Pitlochry and Aberfeldy LEO was cited as an administrative convenience but a nonsense in terms of actual patterns of movement. Then again there was renewed criticism of the use of unemployment and not growth potential as the principal criterion for definition of the Assisted Areas. It was argued that communities such as Glenrothes which had been successful in creating jobs were now to be punished for that success by the removal of their Assisted Area status.

However, on other matters a measure of agreement has emerged in that the new package seems to offer a rather more cost-effective use of the resources to be made available.

The transfer of responsibility for selective assistance to the Scottish Office is a reinforcement of the "one-door" policy for inward investment and it is also a welcome simplification of the arrangements for established firms.

The reduction of the tiers of assistance from three to two further simplifies the situation from the viewpoint of prospective investors. The imposition of the cost per job ceiling on regional development grants removes the most widely criticised aspect of the previous regional policy package.

A glance at the new regional policy map reveals that the availability of RDG together with RSA is concentrated on the areas of greatest need. They are complementary to the range of policies designed to assist the urban areas in Scotland.

Nevertheless, a forecast reduction of between 46% and 68% in expenditure on regional industrial policy can be expected to have some deleterious impact on the performance of the Scottish economy in terms of investment in job creation. These impacts are difficult to estimate with any certainty in the short run. Indeed it is likely that they will only fully manifest themselves over the longer period. In this context it is important to recognise that the vast majority of regional incentives are used by *existing* firms already located within the Assisted Areas. It is the cumulative effect of investment programmes in Assisted Areas over the years which has raised the quality of manufacturing plant. "Silicon Glen" shows how a cluster of companies can create a "critical mass" which gathers its own momentum. For this to happen regional assistance was required in the first place.

Regional policy is sometimes justified on the basis that it will attract "footloose" international firms. It should be recalled, however, that many of these firms remain mobile. They form part of the branch plant syndrome and they are likely to be part of large, multi-sourced enterprises and consequently readily closed when the time comes to replace machinery. Regional incentives are necessary to anchor these firms as well as to attract new ones.

All the evidence suggests that over the years RDG and RSA have been effective in encouraging more employment and more investment in Scotland than would otherwise have been the case. It is by no means certain that the new package, cost-effective in individual cases though it may be, will be able to sustain this record.

Certainly one should not expect too much from the extension of the availability of incentives to service industries. Of course, the services are the sector to which we must look for the major proportion of job creation in the foreseeable future. Employment in services is, however, closely correlated to the overall distribution of population and it would be

unrealistic to expect the existence of regional incentives radically to alter the availability of service employment in favour of the Assisted Areas.

Related to this, it is a significant shortcoming of the recent policy changes that they do not directly address one aspect of regional imbalance which is likely to assume considerable importance over the next decade. It is now widely recognised and, indeed, the Department of Trade and Industry's background paper to the White Paper confirms, that there is a marked concentration of research and development capability in the south-east of the country. The south-east has emerged as the innovative core of the country as a whole, with an infrastructure which facilitates initial innovation and rapid diffusion for all sizes of companies. It seems inevitable that a disproportionate number of the job opportunities, often in high technology associated with innovation, will be located in the south-east rather than in areas such as Scotland. Thus, while the decline of manufacturing jobs in Scotland seems set to continue, most new jobs in high technology and in services are likely to be created in the south-east. This is the "new" regional problem of which Scotland is a part and which the current policy package can do little to solve.

Concluding Remarks

In the introduction to the paper we set out the principal objectives of regional policy as:

(a) bringing labour demand and supply in the Assisted Areas more closely into balance;

(b) helping regions move into self-sustaining growth.

We also noted that at a time of high and rising unemployment and relative and absolute decline in parts of the Assisted Areas it was, at first sight, surprising that there should have been a further reduction in the resources made available for regional industrial incentives.

In understanding the reasoning behind this reduction in resources it is of overwhelming importance that regional policy is now applied in a substantially different climate from that which obtained in the sixties. Then comfortable self-reinforcing arguments saw regional policy as compatible with other aspects of macro-economic policy, notably encouraging a faster rate of growth, controlling inflation and the balance of payments, and reducing unemployment. By the late seventies the national context had markedly changed. With high and rising unemployment in the economy as a whole, regional policy is now perceived by Government largely as a re-distributive mechanism rather than a stimulus to faster national economic growth. Thus, the main case for regional policy is now argued on social grounds. As a readily identifiable element of Government expenditure it has been the subject of detailed scrutiny with a view to achieving a cost-effective package.

Nevertheless in the recent White Paper (Cmnd 9111) and in many subsequent statements, Ministers have re-affirmed their commitment to maintaining an active regional policy. There are certainly strong arguments for adopting this position. In the first place the social problem is likely to become worse. As we have noted there is a consensus among forecasts that labour supply will exceed labour demand by a wide margin for the foreseeable future. The Department of Employment's own labour supply forecast for 1991 predicts unemployment of around 3 million for the U.K. On the supply side the situation may be ameliorated in some regions by net out-migration. However, on the demand side, rigidities in the labour market render it unlikely that there will be a significant fall in labour costs relative to other areas of the country. Thus the forecasts imply unacceptably high levels of unemployment – unacceptable in social terms, but also in economic terms as a waste of the country's scarce resources.

While recognising that regional policy is quite properly subordinate to other major national economic objectives it must also be recognised that national economy is the sum of its local and regional components. Throughout the regions there is strong evidence of de-industrialisation without compensating increase in new jobs from other sources. Regional policy has been aimed, through incentives to capital investment, at the restructuring of local economies. It has been targeted at wealth creation from which jobs will follow. The case for regional policy in areas such as Scotland is now not so much to create the conditions for self-sustaining growth. Rather it is to manage the process of decline in peripheral areas – relative and absolute – in such a way as to minimise economic damage to the economy as a whole and the social disruption to these areas in particular.

The new regional policy package falls short of the wide-ranging review of regional policy and regional planning which is felt necessary by a large body of opinion encompassing not only a variety of disciplines within the academic community but also a broad spectrum of political opinion.

The latest arrangements provide a smaller regional policy cake and Scotland has been allocated a smaller slice of that reduced cake. There is much that is sensible in the new arrangements and there can be little doubt

that they will promote more jobs per £ of expenditure. Nevertheless, while it is not possible to predict with accuracy, it seems inevitable that this recent and further cut in expenditure on regional policy in Scotland will have deleterious impacts on jobs and investment.

Hugh Begg, Department of Town & Regional Planning, Dundee University, Stuart McDowall, St. Andrews University.

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